Remarks by Commissioner Curt Hébert
on
FERC's Role in Merger Review
Washington, D.C.
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As part of the legislative debate on restructuring, policy makers are engaging in a lively discussion about the wisdom of involving FERC in reviewing mergers and our competence in that arena. Two weeks ago, a bipartisan group, the Department of Justice's International Competition Advisory Committee, issued a report on how to make merger review more effective. Most members recommended ending FERC's role. The rest urged reducing it. Along comes the order in the AEP-CSW merger that should, once and for all, end the debate. In imposing conditions beyond those the companies offered, allegedly to remedy anti-competitive harm, FERC proved Congress should remove us from the merger business.

The majority created alleged problems with AEP-CSW's market power as the basis for setting a deadline by which the applicants must join a regional transmission organization (RTO). The date just happened to coincide with the one Order No. 2000 established for the whole industry. The merging utilities are trying very hard to join an RTO. In fact, they have filed as part of the Alliance Transmission Company that seeks approval of a for-profit transmission company. FERC's flexing of its muscle amounts to an empty gesture in practical terms. It does nothing besides providing grist -- watery, to be sure -- for breast-beating speeches on how "tough" FERC will act and how "seriously" the Commission takes formation of RTO's.

Our claimed expertise led FERC to invent market power out of thin air. The Commission reversed the findings of fact of a capable, experienced Administrative Law Judge. The Commission disregarded the testimony of a former Deputy Assistant Attorney General for Antitrust. The Commission found errors in the analysis of FERC's own former chief antitrust economist, who, as Associate Director of Economics for Electricity, had a large hand in writing FERC's merger policy. Once again, the experts were treated as children, with FERC acting as the all-knowing merger agency.

Indeed, neither the text of FERC's findings nor the footnotes contain even one citation to the hearing record. In contrast, the Initial Decision and the Briefs Opposing Exceptions, that find no problem, relied on specific testimony properly in the record.

On top of that, the majority applied a wrong, new legal standard to this case and indulged in bad economics. In short, the law and the facts compel approval of the merger te companies submitted, with the conditions they agreed to. Therefore, I submit, on principle, FERC ought to get out of the merger business and Congress should show us the door.

FERC began the discussion by equating the merger of two integrated electric utilities with that of a gas and an electric company. FERC concluded that vertical merger analysis applies where "the input is transmission." Theoretically, I suppose, a merger between integrated utilities can have vertical aspects. If, in a geographic market, one utility sells transmission only, and, with the merger, acquires generating units, a vertical combination occurs in that location. A merger that adds generating plants to a gas pipeline company also falls under the vertical variety. The AEP-CSW merger order, however, undertook no analysis to support the proposition that anything like this occurred in any of the markets American Electric Power Company (AEP) or Central and Southwest Corporation (CSW), each an integrated utility with generation and transmission, serves.

Labeling this merger vertical turns economic analysis on its head. It converts a pro-competitive merger that adds an entrant to a market, or a neutral one that changes nothing, into a problematic case that, to the majority, decreases competition. That the parties to this case "based" their testimony on vertical principles resulted from our discussion of vertical mergers in the order setting the matter for hearing. Though we asked for testimony on potential vertical effects, we still have the burden of justifying our conclusion that a this merger has vertical characteristics. The AEP merger order made no attempt.

Moreover, having ignored the economics, the majority misconstrued the law. The order dismissed on spurious grounds our longstanding criterion for reviewing mergers. The standard "consistent with the public interest" in section 203 the Federal Power Act narrows our remedial authority to changes in market power the merger creates. We restated that doctrine just last year in *PacifiCorp*, 87 FERC ¶61,288 at 62,151 (1999). The majority gives a flimsy reason for overturning our precedent. *PacifiCorp* involved horizontal issues (direct competitors), while, to the majority, this case implicates vertical (supplier and buyer). Even if true, so what? The provisions of section 203 apply to both.

Next, FERC found fault with the testimony of Dr. Henderson, the former FERC economist. Dr. Henderson considered the exercise of potential market power in transmission as a denial of service. Not so, according to the Commission; Dr. Henderson should have examined other means. In particular, FERC found that harm also resulted from "strategic manipulation of transmission or generation by which the merged company could frustrate competitors' access." The first claim, the one about transmission, I find amorphous. The second, involving generation, I consider irrelevant to market power over transmission.

The majority also criticized Dr. Henderson for considering only the least costly transmission path in his conclusion that the companies have no market power. The reasoning rejecting that analysis consisted of the truism that power flows everywhere on a grid. While accurate as physics, that response misunderstands the effects of mergers. The Applicants pointed out in their Brief Opposing Exceptions, "if the merged company does not provide the least cost path, any foreclosure attempt can be avoided by a supplier arranging for service over the transmission system" of another company. Brief Opposing Exceptions at 75-76, *citing*, Ex. AC-936 at 6.

The order called irrelevant Dr. Henderson's indicator of lack of transmission market power. He used data on the degree of concentration in the generation market. I find the information enlightening. Competition among generators defeats the attempt of the merging parties to force purchases of the generation they acquire. Buyers can go elsewhere. One may argue whether enough competition in generation exists to defeat exercise of any market power in transmission. The majority, however, rushed past the issue. The order simply concluded summarily that "Dr. Henderson's analysis, in fact, shows highly concentrated relevant markets." So much for our "expertise" on the electric industry in the context of mergers.

The majority adopted "Intervenors' independent analyses . . . ." Preliminarily, I disagree with the characterization. Parties with economic interests in the merger, such as the intervenors here, present as much of an "independent" analysis as the applicants. I would argue that, given that the burden of proof lies with the merging companies, perhaps less so. In any event, the order fails to cite any support for this embrace. In contrast, the Administrative Law Judge and the Briefs Opposing Exceptions, including the Trial Staff's, examined the record.

I found important the testimony on rebuttal of Dr. Robert D. Willig, Professor of Economics at Princeton and the former Deputy Assistant Attorney General, who served as Chief Economist for Antitrust. Enron's competition witness, Dr. Peter Fox-Penner, hypothesized that AEP will falsely call an emergency to curtail power flows and, in that way, restrict capacity. Dr. Willing convincingly proved the claim spurious. Dr. Fox-Penner ignored the fact that AEP would then commit an illegal act that the relevant regional reliability councils could detect. As Dr. Willig stated, antitrust adjudicators properly "discard . . . rank speculation about what firms could do, in the imagination of the 'analyst' and without grounding in [reality]. . . . " Ex. AC-1900 at 12. Anyone competent in mergers would have followed that good advice.

The Intervenors pressed another claim of vertical market power. Dr. Fox-Penner claimed that AEP actually favored its own generation in granting requests for transmission. In response, the record showed that Dr. Henderson examined the patterns of power flows across AEP's system. (He saw no need to analyze CSW's because the

Texas Independent System Operator and the Southwest Power Pool tariff control the grids.) He found random patterns of acceptance and refusal between AEP's own generation and those of competitors and explained a vast majority of the alleged refusals. Ex. AC-900 at 43, 49.

As Dr. Willig instructed, to find a realistic exercise of vertical market power, we would need to answer three questions. How high could the merged firm raise prices in the market? How great a risk of detection does illegal conduct create? How profitable would the exercise of market power turn out to be? Ex. AC-1900 at 12. From the majority I hear silence on each. The testimony shows, however: not high enough, very risky and not profitable.

Finally, I would have accepted as sufficient to cure any problem with market power the merging companies' commitment to join an RTO. Given the deadlines we outlined in Order No. 2000, the success of our first collaboration meeting in Cincinnati and the companies' eagerness to join, an RTO in the region will form soon enough. Artificially imposing a date we know the applicants will meet and an expensive scheme of third-party control over calculating transmission capacity and market monitoring serves no reasonable purpose.